STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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September 6, 2006

Dear Interested Party:

Staff has reviewed comments received in response to our July 25, 2006, interested parties meeting regarding proposed regulatory language to clarify the application of tax to third-party rebates. Enclosed is the *Second Discussion Paper* on this subject. This document provides the background and a discussion of the issue. Also enclosed for your review is a copy of new proposed Regulation 1671.1, *Discounts, Coupons, Rebates and Other Incentives* that reflects the current application of tax (Exhibit 1) and new proposed Regulation 1671.1 that reflects an alternative approach to the application of tax (Exhibit 2).

A second interested parties meeting is scheduled for **September 19, 2006, at 10:00 a.m. in Room 122** to discuss the regulatory language for proposed Regulation 1671.1. If you are unable to attend the meeting, but would like to provide input for discussion at the meeting, please feel free to write to me at the above address or send a fax to (916) 322-4530 before the September 19, 2006 meeting. If you are aware of other persons that may be interested in attending the meeting or presenting their comments, please feel free to provide them with a copy of the enclosed material and extend an invitation to the meeting. If you plan to attend the meeting on September 19, 2006, or would like to participate via teleconference, I would appreciate it if you would let staff know by contacting Ms. Lynda Cardwell at (916) 324-2924 or by e-mail at Lynda.Cardwell@boe.ca.gov prior to September 12, 2006. This will allow staff to make alternative arrangements should the expected attendance exceed the maximum capacity of Room 122 and to arrange for teleconferencing.

Any comments you may wish to submit subsequent to the September 19, 2006 meeting must be received by **September 29, 2006**. They should be submitted in writing to the above address. After considering all comments, staff will complete a formal issue paper on the proposed regulatory language to clarify the application of tax to third-party rebates for discussion at the **Business Taxes Committee meeting** scheduled for **November 20, 2006**. Copies of the formal issue paper will be mailed to you approximately ten days prior to this meeting. Your attendance at the November Business Taxes Committee meeting is welcomed and encouraged. The meeting is scheduled for **9:30 a.m.** in Room 121 at 450 N Street, Sacramento, California.

Please be aware that a copy of the material you submit may be provided to other interested parties. Therefore, please ensure your comments do not contain confidential information.

If you are interested in other topics to be considered by the Business Taxes Committee, you may refer to the "Business Taxes Committee" page on the Board's Internet web site (http://www.boe.ca.gov/meetings/btcommittee.htm) for copies of Committee discussion or issue papers, minutes, a procedures manual and calendars arranged according to subject matter and by month.

We look forward to your comments and suggestions. Should you have any questions, please feel free to contact Ms. Leila Khabbaz, Supervisor, Business Taxes Committee Team at (916) 322-5271.

Sincerely,

Jeffrey L. McGuire, Chief
Tax Policy Division
Sales and Use Tax Department

JLM: lrc

Enclosures

cc: (all with enclosures)
Honorable John Chiang, Chair
Honorable Claude Parrish, Vice Chairman
Ms. Betty T. Yee, Acting Member, First District (MIC 71)
Honorable Bill Leonard, Member, Second District (MIC 78)
Honorable Steve Westly, State Controller, C/O Ms. Marcy Jo Mandel (MIC 73)
Mr. Chris Schutz, Board Member's Office, Fourth District (MIC 72)
Mr. Neil Shah, Board Member's Office, Third District (via e-mail)
Mr. Romeo Vinzon, Board Member's Office, Third District (via e-mail)
Mr. Alan LoFaso, Board Member's Office, First District (via e-mail)
Mr. Steve Kamp, Board Member's Office, First District (MIC 71 and via e-mail)
Ms. Mira Tonis, Board Member's Office, First District (via e-mail)
Ms. Margaret Pennington, Board Member's Office, Second District (via e-mail)
Mr. Lee Williams, Board Member's Office, Second District (MIC 78 and via e-mail)
Mr. Ramon J. Hirsig (MIC 73)
Ms. Kristine Cazadd (MIC 83)
Ms. Randie L. Henry (MIC 43)
Mr. Robert Lambert (MIC 82)
Mr. Randy Ferris (MIC 82)
Ms. Denise Riley (MIC 82)
Ms. Janice Thurston (via e-mail)
Ms. Jean Ogrod (via e-mail)
Mr. Jeff Vest (via e-mail)
Mr. David Levine (MIC 85)

Mr. Steve Ryan (MIC 85)
Mr. Todd Gilman (MIC 70)
Mr. Kenneth Topper (via e-mail)
Mr. Dave Hayes (MIC 67)
Ms. Freda Orendt (via e-mail
Mr. Stephen Rudd (via e-mail)
Mr. Joseph Young (via e-mail)
Mr. Vic Anderson (MIC 44 and via e-mail)
Mr. Larry Bergkamp (via e-mail)
Mr. Geoffrey E. Lyle (MIC 50)
Ms. Leila Khabbaz (MIC 50)
Ms. Lynda Cardwell (MIC 50)
Mr. Chuck Arana (MIC 50)

SECOND DISCUSSION PAPER

Proposed Regulatory Language to Clarify the Application of Tax to Third-Party Rebates

I. Issue

Should the Board of Equalization (Board) adopt proposed Regulation 1671.1, *Discounts, Coupons, Rebates and Other Incentives*, to clarify the application of tax to third-party rebates?

II. Staff Recommendation

Staff recommends adopting proposed new Regulation 1671.1, attached as Exhibit 1, to reflect staff's current approach to the application of tax to "third-party rebates." The proposed regulation would also address an additional broad array of coupon, rebate, and discount issues that are believed to be noncontroversial.

Staff's current approach to the application of tax to third-party rebates regards a retailer's rebate income as part of the retailer's gross receipts when the rebate program is not between the retailer and the retailer's direct vendor *and* the payment received by the retailer can be traced in a fixed or determinable manner to particular sales of product (i.e., on a transaction-by-transaction basis). Staff's view is that the third-party payment can be traced to particular sales when the third party requires the retailer to reduce the selling price of the specified products in order for the retailer to receive the rebate payment.

In essence, the retailer merely receives payment for the product from two separate sources, the customer and the third party. Under staff's current approach, a third party is a party other than the customer and the retailer's vendor. Rebate payments received directly from a retailer's vendor (who may be the manufacturer in some cases) are not considered additional gross receipts from a retailer's retail sale. However, in response to comments by interested parties criticizing the two-party/three-party distinction, staff is considering whether it should eliminate this distinction in its audit approach on a going forward basis after effective notice to all affected taxpayers.

III. Other Alternatives Considered

As supported by the California Grocers Association, California Retailers Association, California Nevada Soft Drink Association, and Western States Petroleum Association, adopt proposed new Regulation 1671.1, a draft of which is attached for discussion purposes as Exhibit 2, to mandate a retroactive change to the current audit approach to the application of tax to third-party rebates. The provisions would include "customer knowledge" through documentation of the third-party reimbursement as a factor in determining whether the third-party rebate payments are included in the retailer's gross receipts. In addition, the regulatory provisions regarding third-party rebates would not make a distinction between two-party and three-party transactions and would be operative January 1, 2003. As in the staff recommendation, the proposed new regulation would address the same broad array of coupon, rebate, and discount issues that are believed to be noncontroversial.

SECOND DISCUSSION PAPER

Proposed Regulatory Language to Clarify the Application of Tax to Third-Party Rebates

IV. Background

Retailers and their representatives have disputed the application of tax to certain third-party rebates and buy-downs in recent years. At its January 31, 2006, meeting, the Board directed staff to prepare proposed language for two or more alternative approaches to the taxation of third-party rebates for the Board to consider pursuant to a regulatory process. Staff presented four alternative approaches to the Board during the March 28, 2006, meeting. After a discussion regarding the four approaches, the Board referred the alternative approaches to the Business Taxes Committee's interested parties process for discussion.

Staff held the first interested parties meeting to discuss the alternative approaches on July 25, 2006. The general consensus of the interested parties was that the application of tax to third-party rebates should be tied to document-based customer knowledge of the payment paid by a third party to the retailer in exchange for reducing the selling price of the product sold. The participants also expressed a preference for a comprehensive regulation that provides provisions addressing all types of coupons, discounts, and rebate issues. To accomplish this, interested parties indicated support for merging two of the alternative approaches presented to the Board in March 2006 into a new proposed Regulation 1671.1, with additional examples and clarification. For purposes of discussion and without any intent to convey that staff supports or approves of the language, staff has prepared a draft of a proposed alternative that staff believes reflects the general consensus of the interested parties (attached as Exhibit 2). Staff looks forward to receiving feedback from the interested parties with respect to the draft language.

Following the interested parties meeting, staff received submissions from the following parties: Ms. Kristin Power, California Grocers Association, Mr. Bill Dombrowski, California Retailers Association, Mr. Bob Achermann, California Nevada Soft Drink Association, Mr. Michael D. Wang, Western States Petroleum Association, and Mr. Ned Roscoe.

V. Discussion

California imposes a sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt from taxation by statute. Sales tax is imposed on the retailer who may collect reimbursement from the customer if the contract of sale so provides. Pursuant to Revenue and Taxation Code (RTC) section 6012 (b)(2), gross receipts include all receipts, cash, credits, and property of any kind. However, gross receipts do not include cash discounts allowed and taken on sales (RTC § 6012(c)(1)). Similarly, discounts offered by retailers for sale merchandise or coupons issued by a retailer that do not result in reimbursement from a third party are not included in gross receipts.

The "total amount" of a retailer's retail sale may include amounts collected from someone other than the customer. In particular, pursuant to RTC section 6012(b)(3), staff has considered gross receipts to include amounts a retailer receives from a third party under a buy-down rebate program when the third party requires the retailer to reduce its selling price as a condition of receiving the payment. In staff's view, this treatment is consistent with the principles that impose tax on amounts received upon redemption of manufacturer coupons.

When customers present manufacturer coupons to the retailer, the retailer's gross receipts include amounts paid by the manufacturer for coupons redeemed by the retailer. Manufacturer coupons provide the retailer with a specific reimbursement amount that is part of that retailer's gross receipts. Since the manufacturer agrees to reimburse the retailer the specific amount of the coupon and the retailer in turn is passing on a credit for that reimbursement to the customer, tax applies to the total gross receipts from the sale of the product even though a portion of the selling price is paid by the manufacturer.

Alternative 1 – Change to Current Application of Tax

Alternative 1 reflects an approach similar to the Streamlined Sales and Use Tax Agreement's definition of "sales price," in that it incorporates "knowledge of the rebate" as one of its elements. It includes third-party rebate revenues in gross receipts when the customer presents documentation to the retailer in order to obtain a discount *or* when the third-party reimbursement is noted in the documentation provided to the customer, thereby providing notice to the customer that the third-party reimbursement was required for the reduction in the selling price. The proposed language also includes a requirement that a written or oral contract exists between the manufacturer and the retailer where the retailer agrees to lower the selling price of a product before the third-party consideration can be taxed.

Alternative 1 requires customer knowledge through documentation (i.e., constructive knowledge through signage, etc. does not suffice). Staff agrees with industry that constructive knowledge as a factor for determining whether payments made by third parties to the retailer are included in the retailer's gross receipts would present undesirable administrative and audit difficulties. If the Board were to adopt a regulatory provision that customer knowledge is a factor in determining whether rebate or incentive payments are included in the retailers' gross receipts, staff believes customer knowledge should be based on "direct notice," i.e., knowledge through documentation rather than constructive knowledge, i.e., inferred or implied knowledge.

With regards to the definition of a "third party," the proposed regulatory provisions, as reflected in Alternative 1 (Exhibit 2), define a third party to mean a person other than the retailer or the customer such as a manufacturer or retailer's vendor. The proposed provisions do *not* make a distinction between two-party and three-party transactions when the payments received by the retailer are pursuant to a rebate or incentive program requiring the retailer to reduce the selling price of specific products as a condition of receiving payment under the program.

Interested Parties' Submissions

California Grocers Association (CGA) – In their August 17, 2006, submission, the CGA provided suggestions for revising industry's previously proposed Regulation 1671.1. Industry's previously proposed version is attached as Exhibit 3. The suggestions involved replacing subdivision (d) (with the exception of subdivision (d)(1)) and subdivision (e) with previously proposed subdivision (h) of Regulation 1671 (i.e., Alternative 1 from the first discussion paper, attached as Exhibit 4), with minor revision. These suggested revisions are reflected in subdivision (c) of the proposed draft attached as Exhibit 2. Subdivision (f), *Operative Date*, of industry's previously proposed Regulation 1671.1 (Exhibit 3) is renumbered without further change as subdivision (e) in the draft proposal attached as Exhibit 2.

The CGA also emphasizes their belief that "customer knowledge" is fundamental to the application of sales tax on gross receipts where there is a rebate program. They believe sales tax should apply only to the price agreed upon by the retailer and the customer, as set forth by Business and Professions Code section 12024.2, which requires the total price on an item be based on the price advertised. CGA believes customer knowledge of the buy-down amount is tantamount to a manufacturer coupon addressed in the proposed regulation. They also believe the provisions related to customer knowledge should include a requirement that a written or oral contract exists between the manufacturer and the retailer where the retailer agrees to lower the selling price of a product before the third-party consideration can be taxed.

In addition, the CGA reiterates their concern over the discrepancy in treatment between two-party and three-party transactions. The CGA believes this penalizes small retailers and, large or small, the retailer may not be aware of whether a product purchase is truly from a manufacturer as opposed to a wholesaler/distributor owned by the manufacturer.

California Retailers Association (CRA) – In their August 18, 2006, submission, the CRA notifies staff of their support for combining the provisions of previously proposed subdivision (h), Regulation 1671 (Exhibit 4), with industry's previously proposed Regulation 1671.1 (Exhibit 3). The CRA also expressly supported the revisions suggested by the CGA. Again, for purposes of discussion only, staff's attempt to refect these suggestions in draft form is attached as Exhibit 2.

In addition, the CRA explains that rebate programs are commonplace in the retail industry and many retailers receive payments from manufacturers for "rebates," "buy-downs," or "volume price reductions." Under these programs, manufacturers offer allowances in exchange for the retailer's agreement to reduce the retail price of the manufacturers' product(s). The CRA believes that, in consideration for reducing the retail price, manufacturers retroactively refund a portion of the price the retailer paid to receive their inventory. The CRA further believes the manufacturer-provided allowance constitutes a reduction of the retailer's cost of merchandise and is not a component of the retailer's sales revenue.

Like the CGA, the CRA believes customer knowledge of a manufacturer's reimbursement to the retailer for a reduction in the selling price of a product must be required for rebates to be included in gross receipts. They also believe allowances provided by the manufacturer of which the customer is unaware should not be included in the calculation of sales tax. They believe doing so forces retailers to charge customers sales tax reimbursement measured on a selling price the customers did not pay. Any attempt to collect sales tax reimbursement from the customer based on the shelf price and a separate amount of which the customer is unaware is believed to jeopardize customer relations and exposes retailers to liability under fair pricing laws or unfair business practices statutes.

Further, the CRA believes including manufacturer allowances as part of the retailer's gross receipts imposes significant administrative burdens and costs on retailers. Currently, retailers' point-of-sale systems calculate sales tax based on the retail price scanned at the register and reflected on the customer's receipt. If retailers were to calculate and collect sales tax reimbursement on a price other than that which is actually charged to the customer, substantial modifications to retailers' point-of-sale systems would be required.

California Nevada Soft Drink Association (CNSDA) – In their August 17, 2006, submission, the CNSDA provides their support for adding "customer knowledge" as a requirement for including payments from third parties under a rebate or incentive program in the retailer's gross receipts. The CNSDA believes "customer knowledge" is fundamental to the application of sales tax based on gross receipts when there is a rebate program and that sales tax should be based upon what the customer believes they are paying for the product.

Western States Petroleum Association (WSPA) – In their August 16, 2006, submission, the WSPA states that their members and tax representatives from Valero, ExxonMobil, and Chevron support industry's previously proposed Regulation 1671.1. The WSPA explains that the previously proposed regulation reflects the current dynamic retail environment with respect to when incentives are clearly a reduction of the cost of good sold and when they are essentially "co-payments" and part of the taxable consideration received.

However, the WSPA recommends industry's previously proposed Regulation 1671.1 be revised to include additional examples clearly addressing the tax treatment when tobacco, candy, and other common types of products sold in convenience stores are subject to incentives. The WSPA proposes the following two examples be included in the proposed regulation:

- *"A convenience store operator receives a payment from a manufacturer of tobacco products after the convenience store operator has reached a volume of sales of products as measured in cartons. The manufacturer may or may not have an oral or written agreement with the store operator regarding pricing of the manufacturer's products. The convenience store operator purchases tobacco products from a wholesale distributor. Purchasers of tobacco products have no direct or constructive knowledge of the manufacturer's incentive* *arrangement with the store operator. The payment by the manufacturer to the store operators is not a taxable gross receipts, but a reduction in the cost of goods sold.*

- *A distributor of tobacco products, a non-manufacturer of such products, offers to reduce the price of such products in exchange for a convenience store operator agreeing to fixed promotional price of such products for either a period of time or until such inventory is sold. The purchaser of such products from the store operator does not have actual or constructive knowledge of the wholesale price reduction. The price reduction by the distributor is not a taxable gross receipts, but a reduction in the cost of goods sold."*

Because the draft proposal, presented for purposes of discussion only as Exhibit 2, already contains examples that address the issues covered by the WSPA's suggested examples, the WSPA's examples were not included in the draft proposal set forth in Exhibit 2. To the extent, the interested parties prefer the WSPA's treatment of these issues, this should be brought to staff's attention through the interested parties process.

The WSPA also opines that an auditor reviewing a taxpayer's records for evidence of customer knowledge of a manufacturer's rebate should look to the books and records of the taxpayer for a written statement from the manufacturer regarding requirements that the customer present a coupon for a rebate or that the retailer provide information to the customer regarding a manufacturer's rebate program.

The WSPA adds that previously proposed subdivision (h) of Regulation 1671 (Exhibit 4) would be its second choice for proposed language, provided that additional examples are developed to guide taxpayers and Board audit staff. The WSPA believes staff's previously proposed Regulation 1671.1 and staff's current audit approach are undesirable both in their application and result, as they negate what it believes is the longstanding position of the Board.

Regarding an operative date, WSPA believes industry's previously proposed Regulation 1671.1 (Exhibit 3) merely clarifies the longstanding position of the Board and that its application should be retrospective to include both pending petitions for redetermination, as well as any open periods for refunds.

Mr. Ned Roscoe – In his August 3, 2006, submission, Mr. Roscoe expresses disagreement with staff's current audit approach, concern over the administrative aspects of documenting and applying the "customer knowledge" provisions initially proposed, as well as dissatisfaction with the discrepancy in treatment between two-party and three-party transactions. He believes that payments from third parties should not be included in the retailer's gross receipts whether the payment is received from redemption of a manufacturer's coupon or under a rebate program. Mr. Roscoe also points out the administrative difficulties facing the Board concerning the operative or retroactive date of the proposed regulatory provisions.

Operative Date

As discussed during the July 25, 2006, interested parties meeting, the regulatory provisions for industry's previously proposed Regulation 1671.1 (Exhibit 3) include an operative date of January 1, 2003. It appears this matter requires further discussion if only to take into consideration the time that has passed and the status of pending petitions and claims for refund.

VI. Summary

The application of tax to third-party rebates has been under review and discussion for the past few years. In an effort to clarify the application of tax to third-party rebates, the Board directed staff to meet with interested parties and to discuss regulatory provisions that will best clarify and make specific the application of tax to third-party rebates. Under discussion is whether the proposed regulatory provisions should include staff's current approach (Exhibit 1) or an alternative proposal based on customer knowledge of the third-party rebate (Exhibit 2). All interested parties, representing their own interests or those of large or small retailers, are welcome to submit comments or suggestions on this issue, and are invited to participate in the interested parties meeting scheduled on September 19, 2006.

Prepared by the Tax Policy Division, Sales and Use Tax Department

Current as of 09/05/2006

Proposed Regulation 1671.1. DISCOUNTS, COUPONS, REBATES AND OTHER INCENTIVES.

References: Sections 6011, 6012, Revenue and Taxation Code
Gifts, Marketing Aids, Premiums and Prizes generally, see Regulation 1670
Trading Stamps and Related Promotional Plans generally, see Regulation 1671

(a) IN GENERAL. Manufacturers, vendors, and other third parties often engage in various programs that result in credits or payments made to retailers with respect to a retailer's taxable sale of tangible personal property to an end-use customer. These payments and credits include, but are not limited to, purchase and cash discounts, coupon reimbursements, ad or rack allowances, buy-downs, scanbacks, voluntary price reductions and other incentives, promotions, and rebates. Under certain conditions, payments received by the retailer in the form of rebates or other types of payments or credits for products sold at retail are included in the retailer's gross receipts or sales price from the sale of the product.

(b) DISCOUNTS.

(1) CASH DISCOUNTS are offered by a retailer to its customer for prompt payment by that customer. If the customer makes prompt payment and takes the discount, the retailer's gross receipts are reduced by the amount of the discount. Cash discounts allowed and taken on sales are excluded from gross receipts. If, however, the customer does not make prompt payment, the retailer's gross receipts are the amount billed. Generally, discounts provided to customers utilizing a grocery store discount club card are regarded as cash discounts or retailer coupons.

(2) PURCHASE DISCOUNTS are given by a vendor to that vendor's customer (i.e., a retailer) based upon the amount of prior purchases by that customer. The discounts are regarded as trade discounts and are not additional gross receipts.

(3) AD OR RACK ALLOWANCES are contractual agreements usually between a manufacturer and the retailer to advertise a product, or to give that product preferential shelf space. Ad or rack allowances are also known as "Local Pay," "Display Shelf Payments," or something similar. Such allowances are not related to the retail sale of the underlying product and are not additional gross receipts. Generally, payments to a grocery store retailer pursuant to discounts offered through a grocery store discount club card are regarded as ad or rack allowances.

(4) RETAILER COUPONS are issued by the retailer in paper or paperless form. When utilized by the customer, they entitle the customer to buy tangible personal property at a certain amount or percentage off the advertised selling price. If the customer has not paid any consideration for the coupon, e.g., a coupon clipped from a magazine or newspaper, the coupon represents a true price reduction resulting in a corresponding reduction in the gross receipts from the sale. If, however, the customer has previously given compensation to the retailer for the coupon, e.g., the coupon was purchased as part of a coupon booklet sold by the retailer to the customer, the pro rata share of the cost of the booklet represented by the purchase for which the coupon was given must be included in gross receipts.

(5) MANUFACTURER'S COUPONS are paper or paperless coupons funded by the manufacturer that customers can utilize at the time of purchasing the manufacturer's product, thus entitling customers to a certain amount or percentage off the advertised selling price. Amounts paid by a manufacturer to a retailer for the redemption of a coupon used for the purchase of the manufacturer's products are included in the retailer's gross receipts. The retailer may, by contract, charge the customer sales tax reimbursement on the amount paid by the manufacturer. Manufacturer's coupon programs may be known as "Coupon Redemptions," "Instant Rebates" or by a similar name.

(c) REBATES AND INCENTIVES. These are transactions involving buy-down programs, mark downs, discounts, coupons, rebates, and other price reductions. These rebate programs are also known as "Buy-Down Rebates," "Promotions," "Flex" (Flex Extensions), or by a similar name.

Discounts, Coupons, Rebates and Other Incentives.

(1) For purposes of this subdivision only, the following definitions shall apply:

(A) "Discount" means a reduction in the amount of consideration the customer is required to provide in order to purchase the tangible personal property from a retailer as a result of third-party consideration promised to or received by the retailer.

(B) "Retailer's vendor" means a person who sells tangible personal property for resale directly to the retailer.

(C) "Third party" means a person other than the customer or the retailer's vendor.

(2) When a retailer receives consideration from a third party, such third-party consideration is not subject to tax unless both of the following conditions are met:

(A) The retailer made a retail sale of tangible personal property to a customer at a discount in response to an offer from a third party to provide consideration to the retailer with respect to each such discounted retail sale; and

(B) At the time of the sale, the amount of third-party consideration attributable to the sale was fixed or otherwise determinable by the retailer.

Both conditions above must be met for the rebate or incentive revenue to be considered part of the retailer's gross receipts. If both conditions are not met, the rebate or incentive revenue will not be included in the retailer's gross receipts.

(d) EXAMPLES.

(1) The following are examples of transactions where payments received by the retailer from the manufacturer or other third party are part of the gross receipts from the sale of the product:

(A) Coupon on dog food bag says $2 off at register. Coupon indicates "Manufacturer's Coupon."

(B) The retailer purchases dog food from its vendor, a separate legal entity from the manufacturer. The manufacturer requires that the retailer reduce the selling price of the product by $2. The manufacturer will reimburse the retailer $2 for each item sold at the end of the promotional period. The manufacturer may issue the retailer a rebate check directly or pay the distributor on behalf of the retailer.

(2) The following are examples of transactions where payments received by the retailer from the manufacturer or other third party are reductions to cost and not included in the retailer's gross receipts from the sale of the product:

(A) Coupon on the dog food bag says $2 off at register. There is no indication on the coupon, in a newspaper ad, at the rack, on the receipt, or anywhere else that the retailer will receive $2 from another person to compensate for the $2 price reduction. The coupon is regarded as a retailer's coupon provided the coupon is not otherwise a rebate or incentive described in subdivision (d).

(B) The manufacturer sells dog food direct to the retailer and also issues a rebate check at the end of a promotional period for the sale of the dog food at a reduced selling price. As part of the rebate program, the manufacturer requires that the retailers selling price may not exceed a stated amount. Since this is a two party transaction, the rebate payment to the retailer is regarded as a reduction of the purchase price and not as gross receipts from the sale of the product.

(C) The manufacturer issues a rebate check to the retailer for $2 for each bag of dog food sold during a promotional period without regard to the selling price of the product. The rebate program was based on the number of bags sold and not on the number of bags sold at a reduced selling price. The retailer purchases the products through its vendor, a separate legal entity. Without a required reduction in the selling price of the dog food, the rebate income is regarded as a reduction in the purchase price and not as gross receipts.

(3) The following are examples of transactions involving payments by automobile manufacturers to automobile dealers or end-use customers with respect to the sale or lease of automobiles.

(A) An automobile manufacturer provides a customer with a $1,000 rebate upon the purchase of a specific automobile. Rather than receive payment from the manufacturer, the customer assigns the rebate to the dealer who in turn applies the amount of that rebate toward the customer's payment for the vehicle. The $1,000 payment by the manufacturer is part of the dealer's gross receipts, since the rebate is provided to the customer who uses the rebate amount to partially satisfy that customer's total payment obligation to the dealer. The $1,000 rebate does not constitute a reduction in the retailer's gross receipts as a retailer's coupon, cash discount, purchase discount, or otherwise.

(B) An automobile dealer receives a $500 incentive from the automobile manufacturer for every vehicle sold of a specific model in a given period. The manufacturer does not have an oral or written contract requiring the dealer to sell the specific model at a reduced price. The selling price is based solely on the dealer's discretion. Under these facts, the $500 payment by the manufacturer is not part of the dealer's gross receipts, since the manufacturer does not require a reduction in the retail selling price of the vehicle. The $500 incentive instead constitutes a reduction in the dealer's cost of goods sold.

Proposed Regulation 1671.1. DISCOUNTS, COUPONS, REBATES AND OTHER INCENTIVES.

References: Sections 6011, 6012, Revenue and Taxation Code
Gifts, Marketing Aids, Premiums and Prizes generally, see Regulation 1670
Trading Stamps and Related Promotional Plans generally, see Regulation 1671

(a) IN GENERAL. Retailers often engage in marketing and sales programs in which they issue coupons or other indicia to their customers that entitle the customers to a reduction in the amount they are required to pay for products sold by the retailers. Manufacturers, vendors, and other third parties often engage in various programs that result in credits or payments made to retailers with respect to a retailer's taxable sale of products to an end-use customer. These payments and credits include, but are not limited to, purchase and cash discounts, coupon reimbursements, ad or rack allowances, buy-downs, scanbacks, voluntary price reductions and other incentives, promotions, and rebates. Under certain conditions, payments received by the retailer in the form of rebates or other types of payments or credits for products sold at retail are included in the retailer's gross receipts or sales price from the sale of the product.

For purposes of this regulation, the following definitions shall apply:

(1) "DISCOUNT" means a reduction in the amount of consideration the customer is required to pay in order to purchase products from a retailer.

(2) "DOCUMENTATION" means a written representation or other written notification that third-party consideration has been or will be provided to the retailer. Examples of "documentation" include, but are not limited to, contracts; sales invoices; manufacturer or vendor coupons; gift certificates; customer receipts, and assignments of rebates. The written representation may be on paper, electronically, or through any other means.

"Documentation" does not mean signage; display tags; advertisement in a newspaper or other materials; flyers; promotional materials; statements on the customer's receipt such as "you saved $18 today," or other such general written representations. Written representations of this type do not directly notify the customer of the third-party compensation that will be provided to the retailer to compensate for the reduction in the amount the customer is required to pay.

(3) "THIRD PARTY" means a person other than the customer or the retailer, such as a manufacturer or retailer's vendor.

(b) DISCOUNTS

(1) CASH DISCOUNTS are offered by a retailer to its customer for prompt payment by that customer. If the customer makes prompt payment and takes the discount, the retailer's gross receipts are reduced by the amount of the discount. Cash discounts allowed and taken on sales are excluded from gross receipts. If, however, the customer does not make prompt payment, the retailer's gross receipts are the amount billed. Grocery store discount club cards are generally considered cash discounts.

(2) PURCHASE DISCOUNTS are given by a vendor to that vendor's customer (i.e., a retailer) based upon the amount of prior purchases by that customer. The discounts are regarded as trade discounts and are excluded from gross receipts.

(3) AD OR RACK ALLOWANCES are contractual agreements usually between a manufacturer and the retailer to advertise a product, or to give that product preferential shelf space. Ad or rack allowances are also known as "Local Pay," "Display Shelf Payments," or something similar. Such allowances are not related to the retail sale of the underlying product and are excluded from gross receipts.

(4) RETAILER COUPONS are issued by a retailer in paper or paperless form. When presented to the retailer by the customer, they entitle the customer to buy tangible personal property at a certain

amount or percentage off the advertised selling price. Although the coupons are presented to the retailer to receive a reduction in the selling price, retailer coupons do not result in compensation from a third party. If the customer has not paid any consideration for the coupon, e.g., a coupon clipped from a magazine or newspaper, the coupon represents a true price reduction resulting in a corresponding reduction in the retailer's gross receipts from the sale. If, however, the customer has previously given compensation to the retailer for the coupon, e.g., the coupon was purchased as part of a coupon booklet sold by the retailer to the customer, the pro rata share of the cost of the booklet represented by the purchase for which the coupon was given must be included in gross receipts.

(5) MANUFACTURER COUPONS are paper or paperless coupons funded by manufacturers that customers can utilize at the time of purchasing the manufacturer's product, thus entitling customers to a certain amount or percentage off the advertised selling price. Manufacturer coupons qualify as "documentation" presented by the customer to the retailer to obtain a discount. Amounts paid by a manufacturer to a retailer for the redemption of a coupon used for the purchase of the manufacturer's products are included in the retailer's gross receipts. The retailer may, by contract, charge the customer sales tax reimbursement on the amount paid by the manufacturer.

(c) REBATES AND INCENTIVES

(1) REBATES ISSUED DIRECTLY TO CUSTOMERS. Manufacturers engage in promotional programs in which they offer product rebates directly to the retailer's customers following their purchase of the manufacturer's products. To receive the product rebate, customers are generally required to submit a rebate application form along with any required documentation (e.g., sales receipt) to the manufacturer or manufacturer's representative directly or through the retailer. Once the rebate form and required documents are processed and accepted, the manufacturer or the manufacturer's representative issues the customer a rebate check. Rebates checks issued by manufacturers directly to the retailer's customers are not part of the retailer's gross receipts. In this situation, the customer pays the retailer the full selling price and receives a subsequent rebate directly from the manufacturer.

(2) REBATES AND INCENTIVES ISSUED TO RETAILERS. Retailers engage in rebate and incentive programs with manufacturers or other third parties that result in additional revenue for the retailer when certain conditions are met. These are transactions involving buy-down programs, markdowns, discounts, coupons, rebates, and other price reductions. These rebate and incentive programs are also known as "Buy-Down Rebates," "Voluntary Price Reductions" "Promotions," "Flex" (Flex Extensions), "Coupon Redemptions," "Scanbacks," "Instant Rebates" or by a similar name.

Revenue received by the retailer from these types of programs or other similar types of programs is part of the retailer's gross receipts from the sale to a customer when both of the following conditions are met:

(A) Receipt of the rebate or incentive revenue is conditioned upon the retailer's sale of the product at a reduced selling price. A conditional price reduction exists when the manufacturer, vendor, or other third party requires, through a written or oral contract, the retailer to reduce the retailer's selling price of the product from the regular selling price. The price reduction can be a specific amount or a requirement to not exceed a specified reduced selling price.

(B) The customer has knowledge that the manufacturer, vendor, or other third party will reimburse the retailer for the amount of the price reduction. Customer knowledge of the additional reimbursement is present when the customer presents "documentation" to the retailer to obtain the price reduction; or the "documentation" presented to the customer at the time of sale indicates there is a price reduction.Both conditions above must be met for the rebate or incentive revenue to be considered part of the retailer's gross receipts. If both of the conditions are not met, the rebate or incentive revenue will not be includable in the retailer's gross receipts.

(d) EXAMPLES

(1**)** The following are examples of transactions where the value of the coupons are part of the retailer's gross receipts from the sale of the product:

(A) Customer clips a coupon out of the newspaper and presents it to the retailer at the time of sale to receive a discounted price on the product purchased. The coupon indicates "Manufacturer's Coupon." Since the manufacturer will compensate the retailer for the amount of the price reduction and the customer presents a manufacturer's coupon to the retailer, the value of the coupon is included in the retailer's gross receipts.

(B) Display aisle has a coupon dispenser above a display of cereal boxes. The dispensed coupons indicate $1 off "Fruity Juice Cereal" - "Manufacturer's Coupon." The customer presents the coupon to the retailer along with the box of cereal and is given $1 off the product's selling price.

(C) Coupon on dog food bag indicates $2 off at register. The coupon also indicates "payable by Big Bad Dog Food Co. (BBDF Co.)" or "All promotional costs paid by BBDF Co." The store clerk removes the coupon from the dog food bag and enters the amount of the discount into the register. The customer's sales receipt lists the $2 discount.

(D) Retailer provides its customers with a coupon discount booklet containing coupons accepted by the retailer during sales periods. The booklet includes coupons identified as "manufacturer coupons" and non-identified coupons. Customers remove the coupons from the booklet and present them to the check-out clerk. The value of the coupons identified as "manufacturer coupons" is included in the retailer's gross receipts. The value of the non-identified coupons, however, would generally not be included in the retailer's gross receipts.

(2) The following are examples of transactions where rebate or incentive payments are part of the retailer's gross receipts from the sale of the product:

(A) The retailer purchases dog food from a distributor, a separate legal entity from the manufacturer (BBDF Co.). No coupon is present on the dog food bag. However, a display notice indicates that a $2 "price reduction is made possible by BBDF Co." The amount of $2 is separately itemized on the customer's receipt and identified as a BBDF discount. Since the retailer agrees to reduce the selling price of the product and the customer is provided a receipt ("documentation") identifying the amount of the manufacturer's discount, the discounted amount is included in the retailer's gross receipts. If the customer's receipt did not identify the discount as a manufacturer discount, however, the required conditions would not be met. The display notice does not qualify as "documentation."

(B) The retailer maintains an online sales web site. The retailer enters into buy-down programs with manufacturers in which the manufacturers require the retailer to offer their products at a reduced price. When the customer purchases a discounted product, the customer's invoice lists the selling price less the amount of the manufacturer's discount. The discounted amount is identified as a "manufacturer's rebate." In addition to a receipt the customer may print, the retailer also emails a confirmation to the customer with a copy of the sales data and the rebate information.

(C) Retailer offers a grocery store discount club card. The customer uses the club card when purchasing various products. The customer also presents manufacturer coupons to the store clerk that are scanned along with the club card. The customer's receipt contains the following statement: "You saved $8 today." Although the price reductions associated with the club card are not part of the retailer's gross receipts, the value of the manufacturer's coupons is included in gross receipts.

(D) Retailer purchases cosmetic products directly from the manufacturer. The manufacturer and retailer enter into a buy-down program in which the retailer is required to reduce the selling price of the manufacturer's products. In turn, the manufacturer agrees to compensate the retailer for the amount of the price reduction. The cosmetic packaging includes a coupon with the following statement: $5 off courtesy of Sun Image Cosmetics. The customer presents the coupon to the clerk and is given $5 off the regular selling price. The rebate revenue is included in the retailer's gross receipts.

(E) A cola distributor enters into agreements with retailers that entitle the retailers to reimbusement from the distributor based on the number of 12-packs of cola the retailers sell at a discounted price during the month of July. The amount of the sales discount is dictated by the distributor. At the end of the promotional period, the distributor issues rebate checks to the participating retailers. When the customers purchase the promotional 12-packs, they find a sticker attached to the packaging that states: Happy July! Price reduction courtesy of Sweet Cola Distributing. The register automatically rings up the discounted price and the customer's receipt identifies the discount as a "distributor discount." Discount is included in the retailers' gross receipts.

(3) The following are examples of transactions where the value of the coupons is **not** included in the retailer's gross receipts from the sale of the product:

(A) Retailer has store discount coupons printed in newspaper advertisements. The customers present the coupons when purchasing the advertised products. Although the customers may present a coupon to the retailer, the amount to the discount is not included in the retailer's gross receipts. The retailer's coupon is not a third-party coupon, nor is the retailer reimbursed for the amount of the discount.

(B) Using the example from (d)(1)(D), except in this case, the store register automatically rings up the discounted price or the store clerk scans a coupon from a packet of coupons when the customer does not present the required coupon. Although the customer's receipt shows the amount of the discount, it is not identified as a third-party discount. Thus, the amount of the discount is not included in the retailer's gross receipts. The customer did not present "documentation" to the store clerk, nor was the customer provided "documentation" at the time of sale.

(4) The following are examples of transactions where rebate and incentive payments are **not** included in the retailer's gross receipts from the sale of the product:

(A) Coupon on the dog food bag says $2 off at register. There is no indication on the coupon, on the customer's receipt, or on any other related documentation that the retailer will receive $2 from another party to compensate for the $2 price reduction. Whether or not the price reduction is based on an agreement with a third party to reduce the selling price of the dog food, the customer did not present or receive "documentation" that demonstrates the customer had knowledge of the reimbursement from a third party.

(B) A cola distributor enters into agreements with retailers that entitle the retailers to compensation from the distributor based on the number of 12-packs of cola the retailers sell during the month of July. The retailers may or may not reduce the selling price of the 12-packs. At the end of the promotional period, the distributor issues rebate checks to the participating retailers. Since the retailer is not required to reduce the selling price of the product, the additional revenue is not included in the retailer's gross receipts.

(C) A cigarette manufacturer enters into agreements with retailers to advertise the manufacturer's products and to provide the cigarettes with preferential shelf space. Retailers that agree to the manufacturer's terms receive compensation from the manufacturer at the end of the promotional period. Since the agreements are not based on a selling price reduction, the payments are not included in the retailers' gross receipts.

(D) A retailer's vendor agrees to discount the retailer's November purchases of Christmas products by 20% if the retailer's total sales for October exceed a specific amount. The retailer increases its purchases during October, gives the products preferential shelf space and advertises the products at 10% off. Although the retailer reduced the selling price of the products, a price reduction was not a condition of the agreement. The purchase discount is a reduction to the retailer's cost of good sold, not additional gross receipts.

(5) The following are examples of transactions involving payments by automobile manufacturers to automobile dealers or end-use customers with respect to the sale or lease of automobiles.

(A) An automobile manufacturer provides a customer with a $1,000 rebate upon the purchase of a specific automobile. Rather than receive payment from the manufacturer, the customer assigns the rebate to the dealer who in turn applies the amount of that rebate toward the customer's payment for the vehicle. The $1,000 payment by the manufacturer is part of the dealer's gross receipts, since the rebate is provided to the customer who uses the rebate amount to partially satisfy that customer's total payment obligation to the dealer. The $1,000 rebate does not constitute a reduction in the retailer's gross receipts as a retailer's coupon, cash discount, purchase discount, or otherwise.

(B) An automobile dealer receives a $500 incentive from the automobile manufacturer for every vehicle sold of a specific model in a given period. The manufacturer does not have an oral or written contract requiring the dealer to sell the specific model at a reduced price. The selling price is based solely on the dealer's discretion. Under these facts, the $500 payment by the manufacturer is not part of the dealer's gross receipts, since the manufacturer does not require a reduction in the retail selling price of the vehicle. The $500 incentive instead constitutes a reduction in the dealer's cost of goods sold.

(e) OPERATIVE DATE

(1) General Rule – The provisions of subdivision (c) shall apply to transactions that occur or petitions for redeterrmination filed but not yet final on or after the first day of the first quarter commencing after this regulation is approved by the Office of Administrative Law.

(2) Application to Pending Controversies.

(A) The provisions of subdivision (c) shall apply to petitions for redermination filed but not yet final as of operative date in (e)(1).

(**B)** The provisions of subdivision (c) shall apply to claims for refund filed but not yet final as of January 1, 2003.

Proposed Regulation 1671.1. DISCOUNTS, COUPONS, REBATES AND OTHER INCENTIVES.

References: Sections 6011, 6012, Revenue and Taxation Code
Gifts, Marketing Aids, Premiums and Prizes generally, see Regulation 1670
Trading Stamps and Related Promotional Plans generally, see Regulation 1671

(a) IN GENERAL. Manufacturers, vendors, and other third parties often engage in various programs that result in credits or payments made to retailers with respect to a retailer's taxable sale of tangible personal property to an end-use customer. These payments and credits include, but are not limited to, purchase and cash discounts, coupon reimbursements, ad or rack allowances, buy-downs, scanbacks, voluntary price reductions and other incentives, promotions, and rebates. Under certain conditions, payments received by the retailer in the form of rebates or other types of payments or credits for products sold at retail are included in the retailer's gross receipts or sales price from the sale of the product.

(b) DISCOUNTS.

(1) CASH DISCOUNTS are offered by a retailer to its customer for prompt payment by that customer. If the customer makes prompt payment and takes the discount, the retailer's gross receipts are reduced by the amount of the discount. Cash discounts allowed and taken on sales are excluded from gross receipts. If, however, the customer does not make prompt payment, the retailer's gross receipts are the amount billed. Grocery store discount club cards are generally considered cash discounts.

(2) PURCHASE DISCOUNTS are given by a vendor to that vendor's customer (i.e., a retailer) based upon the amount of prior purchases by that customer. The discounts are regarded as trade discounts and are excluded from gross receipts.

(3) AD OR RACK ALLOWANCES are contractual agreements usually between a manufacturer and the retailer to advertise a product, or to give that product preferential shelf space. Ad or rack allowances are also known as "Local Pay," "Display Shelf Payments," or something similar. Such allowances are not related to the retail sale of the underlying product and are excluded from gross receipts.

(c) COUPONS.

(1) RETAILER COUPONS. A retailer may issue paper or paperless coupons which, when presented to the retailer by the purchaser, entitles the purchaser to buy tangible personal property at a certain amount or percentage off the advertised selling price. If the customer has not paid any consideration for the coupon, e.g., a coupon clipped from a magazine or newspaper, the coupon represents a true price reduction resulting in a corresponding reduction in the gross receipts from the sale. If, however, the customer has previously given compensation to the retailer for the coupon, e.g., the coupon was purchased as part of a coupon booklet sold by the retailer to the customer, the pro rata share of the cost of the booklet represented by the purchase for which the coupon was given must be included in gross receipts.

(2) MANUFACTURER'S COUPONS. A manufacturer may fund paper or paperless coupons that customers can utilize at the time of purchasing the manufacturer's product, thus entitling customers to a certain amount or percentage off the advertised selling price. Amounts paid by a manufacturer to a retailer for the redemption of a coupon used for the purchase of the manufacturer's products are included in the retailer's gross receipts. The retailer may, by contract, charge the customer sales tax reimbursement on the amount paid by the manufacturer.

(d) REBATES AND INCENTIVES. These are transactions involving buy-down programs, mark downs, discounts, coupons, rebates, and other price reductions. These rebate programs are also known as "Buy-Down Rebates," "Voluntary Price Reductions" "Promotions," "Flex" (Flex Extensions), "Coupon Redemptions," "Scanbacks," "Instant Rebates" or by a similar name.

Revenue received by the retailer from these types of programs or other similar types of programs is part of the retailer's gross receipts from the sale to a consumer when both of the following conditions are met:

(1) The manufacturer requires a reduction in the retailer's product selling price. A price reduction exists when the manufacturer requires, through a written or oral contract, the retailer to reduce the retailer's selling price of the product from the regular selling price. The price reduction can be a specific amount or a requirement to not exceed a specified reduced selling price. The fact that a retailer lowers his or her retail price and receives payment under a rebate program is not evidence that a contractual requirement exists to reduce the price as a condition for receiving payment.

(2) The customer has knowledge that the manufacturer will reimburse the retailer for the specified price reduction. The customer knowledge can be in the form of a receipt, sticker, sign, display or other indicator that the retailer will receive a payment from the manufacturer for a specific amount in return for a reduction in the selling price of the product.

Both conditions above must be met in order for rebate income to be considered part of the retailer's gross receipts. If all the conditions are not met, the rebate income will be considered a purchase discount and not includable in the retailer's gross receipts.

(e) EXAMPLES.

(1) The following are examples of situations where payments received by the retailer from the manufacturer are part of the gross receipts from the sale of the product:

(A) Coupon on dog food bag says $2 off at register. The coupon indicates "payable by Big Bad Dog Food Co. (BBDF Co.)" or "All promotional costs paid by BBDF Co."

(B) Coupon on dog food bag says $2 off at register. Newspaper ad, notice at rack, or on receipt or elsewhere says "$2 coupon payable by BBDF Co."

(C) The retailer purchases dog food from a distributor, a separate legal entity from the manufacturer (BBDF Co.). No coupon is present on the dog food bag. However, a newspaper ad or display notice states that a "price reduction is made possible by BBDF Co." and $2 is separately itemized on the retailer's receipt as the amount of price reduction.

(2) The following are examples of situations where payments received by the retailer from the manufacturer are reductions to cost and not included in the retailer's gross receipts from the sale of the product:

(A) Coupon on the dog food bag says $2 off at register. There is no indication on the coupon, in a newspaper ad, at the rack, on the receipt, or anywhere else that the retailer will receive $2 from another person to compensate for the $2 price reduction. The coupon is regarded as a retailer's coupon provided the coupon is not otherwise a rebate or incentive described in subdivision (d).

(B) Sign at display says "price reduction made possible by BBDF Co." Bag is priced at $10, but there is no indication in a newspaper ad, at the rack, on the receipt, or anywhere else of the amount of the price reduction.

(3) The following are examples of situations involving payments by automobile manufacturers to automobile dealers or end-use customers with respect to the sale or lease of automobiles.

(A) An automobile manufacturer provides a customer with a $1,000 rebate upon the purchase of a specific automobile. Rather than receive payment from the manufacturer, the customer assigns the rebate to the dealer who in turn applies the amount of that rebate toward the customer's payment for the vehicle. The $1,000 payment by the manufacturer is part of the dealer's gross receipts, since the rebate is provided to the customer who uses the rebate amount to partially satisfy that customer's total payment obligation to the dealer. The $1,000 rebate does not constitute a reduction in the retailer's gross receipts as a retailer's coupon, cash discount, purchase discount, or otherwise.

(B) An automobile dealer receives a $500 incentive from the automobile manufacturer for every vehicle sold of a specific model in a given period. The manufacturer does not have an oral or written contract requiring the dealer to sell the specific model at a reduced price. The selling price is based solely on the dealer's discretion. Under these facts, the $500 payment by the manufacturer is not part of the dealer's gross receipts, since the manufacturer does not require a reduction in the retail selling price of the vehicle. The $500 incentive instead constitutes a reduction in the dealer's cost of goods sold.

(f) OPERATIVE DATE.

(1) General Rule – The provisions of subdivision (d) shall apply to transactions that occur or petitions for redeterrmination filed but not yet final on or after the first day of the first quarter commencing after this regulation is approved by the Office of Administrative Law.

(2) Application to Pending Controversies.

(A) The provisions of subdivision (d) shall apply to petitions for redermination filed but not yet final as of operative date in (f)(1).

(B) The provisions of subdivision (d) shall apply to claims for refund filed but not yet final as of January 1, 2003.

Regulation 1671. Trading Stamps and Related Promotional Plans.

Reference: Sections 6006, 6011 and 6012, Revenue and Taxation Code.

(a) Introduction. A variety of sales promotion plans involving premiums are in use by retailers. Common to these plans are some indicia furnished by the retailer to his customers based on the amount of purchases. Examples of such indicia are trading stamps, coupons, tickets and cash register tapes. Given quantities of indicia are surrendered by the customer in exchange for the premium.

(b) Description of Plans. For the purposes of this regulation, these plans may be divided into three types, as follows:

(1) At or near the time of making the sale the retailer incurs expense with relation to the premium by paying a third party, which third party assumes the obligation to furnish the premium to the retailer's customer. The retailer's payment to the third party is not dependent on his customer subsequently surrendering the indicia in exchange for the premium.

(2) The retailer incurs no expense with relation to the premium until such time as the customer obtains the premium. The retailer purchases the premium and delivers it to his customer in exchange for the required quantity of indicia.

(3) The retailer incurs no expense with relation to the premium until about the time the customer obtains the premium. A third party delivers the premium to the customer in exchange for the required quantity of indicia. The retailer pays the third party on an agreed basis related to premium merchandise delivered to the customer by the third party.

The typical trading stamp plan falls under (1) above. The typical cash register tape plan falls under (2) or (3) above.

(c) Cash Discounts Generally. Cash discounts allowed and taken on taxable retail sales may be excluded from the measure of the tax. The promotion plans described above constitute cash discounts. The cash discount is allowed by the retailer and taken by the customer at the time the retailer incurs the expense with relation to the premium.

(d) Plan Described in (b)(1).

(1) Cash Discount. The retailer is entitled to a cash discount deduction at the time he pays the third party who undertakes to redeem the indicia used in the plan. The amount of the cash discount shall be computed on the basis of the amount the retailer pays to the third party for the indicia. See paragraph (g) below for proration of cash discount where retailer's sales are not all taxable.

(2) Sale of Premium. The delivery of premium merchandise in exchange for a prescribed number of units of indicia used in this type of plan constitutes a taxable retail sale of the premium merchandise by the person delivering the merchandise (assuming that the premium merchandise is of a kind the retail sale of which is subject to tax). The selling price is the average amount paid to the third party by its customers for the indicia surrendered in exchange for the premiums.

(e) Plan Described in (b)(2).

(1) Cash Discount. The retailer incurs the expense with relation to the premium at the time he delivers the premium to his customer. The retailer is entitled to a cash discount deduction at the time he delivers the premium to his customer. The amount of the cash discount deduction shall be the selling price of the premium as determined by paragraph (e)(2) below. Since the cash discount relates to the previous sales on which indicia of some kind were issued to customers and which indicia are surrendered in exchange for the premium, the retailer is not entitled to the full cash discount deduction unless the previous sales on which indicia were

issued were all taxable retail sales. Where some, but less than all, of such previous sales were taxable retail sales the retailer shall be allowed a portion of the cash discount as a deduction. See paragraph (g) below.

(2) Sale of Premium. The delivery of premium merchandise by the retailer to his customer in exchange for a prescribed number of units of indicia constitutes a taxable retail sale of the premium merchandise (assuming that the premium merchandise is of a kind the retail sale of which is subject to tax). The selling price is the sales price to the retailer of the premium merchandise.

(f) Plan Described in (b)(3).

(1) Cash Discount. If a third party delivers the premium to the customer and the retailer pays such third party on an agreed basis related to premium merchandise delivered to the customer by the third party, the retailer is entitled to a cash discount deduction for the reporting period in which he pays the third party. The amount of the cash discount is the amount of the payment to the third party.

If the retailer's sales are not all taxable retail sales, there must be a proration of the cash discount. See paragraph (g) below.

(2) Sale of Premium. The delivery of premium merchandise by a third party to a retailer's customer in exchange for a prescribed number of units of indicia is a taxable retail sale (assuming the premium merchandise is of a kind the retail sale of which is subject to tax). The selling price is the amount received by the third party.

(g) Proration of Cash Discount Between Taxable and Exempt Transactions. If the retailer makes taxable sales and also engages in exempt transactions (for example, sales of food or services such as dry cleaning), and issues indicia on both taxable and exempt transactions, the cash discount must be prorated between taxable and exempt transactions and the cash discount deduction on his sales tax return may be taken only for cash discounts on taxable sales. In making tax returns, the retailer may use the following formula to determine the proration of cash discounts to taxable sales:

Taxable sales of the current reporting period on which indicia are issued divided by all transactions of the current reporting period on which indicia are issued.

If upon audit this formula is shown to produce an incorrect proration, an appropriate determination or refund will be made.

(h) RETAILER'S RECEIPT OF THIRD-PARTY CONSIDERATION.

(1) For purposes of this subdivision only, the following definitions shall apply:

(A) "Discount" means a reduction in the amount of consideration the purchaser is required to provide in order to purchase the tangible personal property from a retailer as a result of third-party consideration promised to or received by the retailer.

(B) "Documentation" means a written representation or other written notification that third-party consideration has been or will be provided to the retailer. Examples of documentation include, but are not limited to, contracts, coupons, certificates, invoices, receipts and assignments of rebate. The written representation may be made on paper or electronically or through any other means.

(C) "Retailer's vendor" means a person who sells tangible personal property for resale directly to the retailer.

(D) "Third party" means a person other than the purchaser or the retailer's vendor.

(2) When a retailer receives consideration from a third party, such third-party consideration is not subject to tax unless one of the following conditions is met:

(A) The purchaser presented documentation to the retailer to obtain a discount; or

(B) The documentation provided to the purchaser at the time of sale indicates there is a discount.

(3) This subdivision does not address consideration, rebates, credits, cash discounts or similar payments or allowances provided by a retailer's vendor to the retailer.

(4) Examples of application of tax.

(A) Example 1. A 2-liter bottle of carbonated cola retails for $2. The cola manufacturer promises to pay the retailer $0.20 for every bottle sold at retail for $1.80. The manufacturer is not the retailer's vendor. The purchaser is unaware of the discount in that the purchaser did not present any documentation to the retailer to obtain the $0.20 discount and the discount was not reflected in the documentation the retailer provided to the purchaser at the time of sale. The taxable measure of the retail sale is $1.80.

(B) Example 2. A dog food manufacturer distributes coupons reflecting that the manufacturer will pay $2 toward the retail selling price of a bag of dog food. The bag of dog food retails for $30. The manufacturer is not the retailer's vendor. The purchaser presents the manufacturer's coupon and pays $28 for the dog food. The taxable measure of the retail sale is $30.

(C) Example 3. A father purchases a gift certificate for his daughter, entitling her to $25 toward the purchase of goods at a particular store. No tax was due on the father's purchase of the gift certificate. The daughter presents the certificate for redemption when she purchases a book that retails for $30 and pays the $5 difference with her own money. The taxable measure of the retail sale is $30.